HEBERT, SCHENK & JOHNSEN, P.C.
1440 E. Missouri Avenue
Missouri Commons Suite 125
Phoenix, Arizona 85014-2459
Telephone: (602) 248-8203
Facsimile: (602) 248-8840
E-Mail Address: cjj@hsjlaw.com

Carolyn J. Johnsen - 011894
Attorneys for Debtor

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re: LEEWARD HOTELS, L.P., an Arizona limited partnership, Debtor.	Chapter 11 Proceedings Case No. B-99-09162-ECF-GBN **DEBTOR'S RESPONSE TO MOTION TO MODIFY EXCLUSIVITY** Date: January 10, 2000 Time: 10:30 a.m. Courtroom: 4, 10th Floor

When the Supreme Court hands down a notable decision such as the recent case of In re 203 North LaSalle Street Partnership, ____ U.S. ____, 119 S. Ct. 1411 (1999) ("203 North LaSalle"), practitioners are anxious to be at the forefront of its interpretation. The problem in the present case is that in their zest to induce a ruling based on 203 North LaSalle, creditors Lennar and Amresco [1] (collectively "Creditors") not only have raised the issue prematurely, they have glossed over a critical point: 203 North LaSalle which addresses the absolute priority rule is not applicable to full-pay plans as proposed by the Debtor in this case. Consequently, the Creditors have failed to present any basis for terminating exclusivity.

I. BACKGROUND

Debtor is an Arizona limited partnership formed on March 29, 1999 for the purpose of allowing its general partner Kilburg Hotels, L.L.C. ("Kilburg Hotels"), an Arizona limited liability company in which

[1] As servicing agents for LaSalle National Bank

William J. Kilburg ("Kilburg") is the managing member to consolidate in one entity a number of hotel purchases. The Debtor owns 12 hotels (collectively, "Hotels"), containing a total of 1308 rooms and employing 450 people. The Hotels are located in Texas, New Mexico, Kansas and Missouri. Lennar claims a lien on 10 of the Hotels and Amresco claims a lien on one of the Hotels. Kilburg Hotels acquired an interest in the Hotels in February 1999; the Debtor acquired the Hotels in April 1999. The Hotels are managed by Kilburg Management, L.L.C. ("KMGMT") pursuant to a Management Agreement which provides for a management fee of three and one-half percent (3-1/2%), plus $1,500.00 per month per Hotel for centralized accounting services.

Pre-Bankruptcy Negotiations

Although Lennar would have the Court believe differently, Lennar's involvement with Kilburg and the Debtor existed months before the filing of the bankruptcy. Each of the Hotels had originally been acquired by Samoth Capital Corporation ("SCC") for its hotel investment portfolio. While in the employ of SCC, Kilburg became familiar with each of the properties and its operations. Kilburg terminated his employment with SCC in January 1999 in order to establish Kilburg Hotels as an independent hotel operation and KMGMT as a hotel management company. Kilburg Hotels entered into an agreement with SCC and/or its related entities for the purchase of the twelve Hotels.

Immediately upon closing in February 1999, Kilburg informed Lennar that it had acquired the Lennar Hotels and had taken over the management of the properties. Lennar requested and received from Kilburg copies of the Samoth purchase contract; information regarding bank accounts, insurance, payables; the corporate structure of Kilburg Hotels; projections; management contract, budget and personnel. Lennar hired a third-party consultant to visit the properties and verify Kilburg's budgets. The Lennar expert concurred with the Kilburg analysis in all material respects.

Kilburg received notice in March that Lennar intended to foreclose on the four Lennar Hotels in Texas on April 6, 1999. However, Lennar agreed to forebear to May 4, 1999 if Kilburg would pay to it the net cash flows from the Lennar Hotels. An additional forbearance period was granted until June 1, 1999. From March 15, 1999 to July 20, 1999 a total of $775,000 was paid to Lennar. In April 1999, Kilburg informed Lennar it had transferred the Hotels to the Debtor.

Despite ongoing good-faith negotiations and the huge cash payments, Lennar declined to postpone its foreclosure sale scheduled for August 3, 1999 on the Lennar Hotels located in Texas. Debtor filed its bankruptcy petition on August 2, 1999 to protect its interests in the Hotels.

Immediately after taking over the management of the Hotels, Kilburg Hotels informed Amresco that it had acquired an interest in the Albuquerque Hotel and proceeded to propose a workout structure with Amresco. Those negotiations were finalized in July, resulting in a structure agreed to by both parties subject to documentation which was not completed because of the filing of the bankruptcy.

Present Status of the Case

Lennar tries to persuade the Court that the transfer of the hotels and Kilburg's failure to pour "at risk" capital into the hotels has been harmful. In actuality, Kilburg's operation and management has and will be the saving grace for the over 800 unsecured creditors in this case, all of whom would have been cast aside by Lennar had it foreclosed pre-petition on the hotels. It is certainly an issue as whether Lennar intends to stymie payment to other creditors through its proposed plan.

Since the filing, as demonstrated by the Debtor's interim financial reports, Debtor has operated the hotels efficiently and economically and has been paying post-petition debts. It has entered into an agreement with GMAC, one of its major secured creditors, to allow for a foreclosure on the Lubbock Hotel in full satisfaction of the debt. The agreement also provides for the payment of $70,000 in pre-petition debt and $60,000 in current operating expenses. In essence, the settlement eliminates a significant amount of debt for the estate.

Plan Filing

The Debtor filed its voluntary petition under Chapter 11 on August 2, 1999. Pursuant to 11 U.S.C. § 1121, the Debtor had the exclusive right to file a plan of reorganization until November 30, 1999 which was 120 days after the filing. Debtor filed its Plan of Reorganization ("Plan") and Disclosure Statement on October 29, 1999, well within the exclusive period. Because of the timely filing, Debtor's exclusivity has extended to 180 days from the filing in order to allow the Debtor to obtain acceptances of its Plan. See 11 U.S.C. § 1121(c); In re Corvus, Corp., 122 B.R. 685,686 (Bank. E.D. Va. 1991). That date expires on January 31, 2000 unless otherwise extended by the Court pursuant to 11 U.S.C. § 1121(d).

Fifteen days after Debtor filed its Plan, Lennar filed the present motion to modify exclusivity. Attached to the pleading is what appears to be a liquidating plan although it is difficult to analyze Lennar's proposed plan since no disclosure statement has been provided. In addition, the Debtor is circumspect in discussing Lennar's proposed plan with any detail since a copy has not been provided to creditors.

Although the Debtor's Plan and Disclosure Statement were filed the end of October, the Court did not quickly set a hearing on approval of the Disclosure Statement. The hearing has been scheduled for January 10, 2000.

Overview of Plan

The Creditors have wholly mis-characterized Debtor's Plan. It is intended to provide payment in full to all creditors. In fact, the Debtor specifically indicates the Plan is "full-pay" on page 13 of the Disclosure Statement and page 10 of the Plan. In sum, the Plan provides for payment of approximately $35,000,000 in debt over a seven year period. Creditors have been divided into 27 classes. Administrative claims of about $150,000 are paid at confirmation. Priority claims of about $525,000 are paid over six years with interest. Secured claims are separately classified and include real estate taxes and mechanic's lienholders totaling approximately $235,000 which are paid in full in the first year of the Plan. Lennar is paid its allowed secured debt over seven years and then paid in full at the end of seven years by either a refinance or sale of the hotels. Similarly, Amresco is paid its contract rate until its hotel collateral is sold or refinanced within two years. Unsecured claims estimated at nearly $5,000,000 including Lennar are paid over the life of the Plan. Lennar complains that it is still owed a portion of its debt at Plan maturity. However, as indicated in the Plan and Disclosure Statement, the hotels claimed as Lennar's collateral will be sold or financed at or before that time and Lennar will be paid in full. See e.g. Disclosure Statement, page 15; Plan, page 11. Debtor believed this fact was clear in its filings, but to the extent necessary will provide additional clarification by means of an amendment to the Disclosure Statement.

Despite, Amresco's contentions, the Debtor is paying interest on unsecured claims. The Plan provides for an interest rate equal to the lesser of 6 percent or the federal judgment rate which as of the filing of this pleading is 5.67 percent. Although, the issue of whether this rate is appropriate is reserved for confirmation, a plan providing for such a rate is clearly confirmable. See In re Dow Corning Corp., 1999 WL 617913 (Bankr. E.D. Mich.).

Lennar laments that there is no fresh capital in this Plan. That is untrue. The Plan contemplates an agreement with Best Franchising Inc. through which approximately $530,000 will be infused into the Debtor for use in renovations and upgrades for various of the hotels. The agreement requires the guarantee of Kilburg L.L.C. and a second lien on the hotels, thereby supplying the "risk" Lennar deems is necessary for this Plan to be real.

II. MODIFICATION OF EXCLUSIVITY

Lennar treats Debtor's exclusivity rather cavalierly citing as authority its belief that flexibility is the key, that its sheer debt size places it in the best position to file a plan, and that the Debtor's plan is unconfirmable on its face because of its failure to comply with 203 North LaSalle. Amresco joins in the 203 North LaSalle theory and adds that Debtor's exclusivity should be terminated now because it will expire at the end of January anyway. None of these assertions support a modification of exclusivity.

Legal Standard

Section 1121(d) of the Bankruptcy Code provides that the Court "may for cause reduce or increase the 120-day period or the 180-day period . . ." (emphasis added). However, a party requesting termination of exclusivity bears a heavy burden. Matter of Interco Inc., 137 B.R. 999, 1000 (Bankr. E.D. Mo. 1992); In re Texaco, Inc. 81 B.R. 806,813 (Bankr. S.D.N.Y. 1988). In cases where exclusivity has been terminated, the debtor has typically been subject to gross mismanagement or acrimonious feuding among its principals which has led the court to conclude that shortening exclusivity and permitting competing plans would be beneficial to creditors. See In re Texaco, Inc. 81 B.R. at 812; In re Grand Traverse Development Co. Ltd. Partnership, 147 B.R. 418, 420 (Bankr. W.D. Mich. 1992). No factors exist in this case which compel a shortening of exclusivity.

Debtor Has Diligently Moved This Case Forward

This case is significant in size with 12 operating hotels in four states. There are over 800 unsecured creditors and about $35,000,000 in total debt. The Debtor has vigorously pursued its Plan which it filed in three months after filing the case and which provides for payment in full to all creditors. Debtor has reached a beneficial settlement with one of its major creditors and it has operated the hotels in an efficient manner and paid its post-petition expenses as they have become due.

In Matter of Interco, Inc., supra, the court denied a motion to modify the 180-day exclusivity period based on its findings that the debtors were making good faith progress toward reorganization and were acting in good faith and that the debtors were paying post-petition debt as it became due. Although the court noted not all of the terms of the proposed plan were acceptable to all parties and there were no assurances of confirmation, it determined no circumstances had been presented overcoming the statutory time allowed to the Debtor in filing its Plan and soliciting its acceptances.

Similarly, in In re Grand Traverse Development Co. Ltd. Partnership, supra, the Court refused to shorten exclusivity based on the debtor's diligence in moving the case toward confirmation. The court stated, "To the extent that the [Debtor's] plan may be confirmable, the filing of a competing plan at this point in time would seriously erode the Debtors' chance of reaching confirmation, thus effectively diminishing the protection which the exclusivity period of § 1121 (b) is intended to afford diligent debtors." Id. at 420. The court concluded with a comment on the "policy of encouraging consensual reorganizations." It noted that the filing of a competing plan would lead to confirmation of either plan only by cramdown and that negotiations toward reorganization would be more beneficial. Id. at 421.

In the present case, this Debtor has presented a text-book scenario for reorganization. It filed well within the exclusivity period. It presented a plan which provides for the full payment to creditors over a short seven-year period. Its actions post-petition have been exemplary. It has negotiated and complied with cash collateral stipulations and budgets since the filing. It has reached a settlement with a major creditor. These factors merit against modification of exclusivity. As in the Grand Traverse case cited above, this Court should consider the fact that Debtor has in good faith reached one settlement and was in extensive settlement negotiations with its other major creditors pre-petition. A single plan will allow the Debtor to continue efforts to reach a consensual plan.

The 203 North LaSalle Analysis is Both Premature and Inapplicable

In order to even reach the 203 North LaSalle analysis, the Court and all parties must make several premature assumptions. First, it must be assumed that confirmation will be pursuant to § 1129 (b), known as the cramdown section because Debtor will be unable to obtain the requisite number of acceptances. It is impossible for the Court to make that determination at this juncture. The Disclosure Statement has not been approved and

Debtor has not had the opportunity to solicit its plan. It cannot be predicted with certainty the result of the eventual balloting. Second, even it can be assumed that Lennar will vote against any plan, it is questionable at this juncture whether Lennar will be entitled to vote. As indicated in Debtor's Disclosure Statement at page14, Lennar was the recipient of a $550,000 preference. Debtor has prepared and will file a complaint to avoid the preference and recover the amount for the estate. Pursuant to 11 U.S.C. § 1126, only the holder of a claim allowed under § 502 is permitted to accept or reject a plan. Section 502(d) provides that a claim of an entity from which a preference is recoverable is disallowed unless the entity has paid to the estate the recoverable amount. Debtor maintains that until Lennar pays the preference, it has a disallowed claim and is not entitled to vote on the Plan. Finally, because Debtor's plan provides for payment in full, any opposition calls into question the party's bad faith under 11 U.S.C. § 1126(e). Thus, as the case exists before the Court today, it is unknown what the status of creditors will be, how the balloting process will progress, or just how confirmation will evolve.

Even if it is determined now that confirmation will proceed under § 1129(b) which allows confirmation without all accepting classes, the 203 North LaSalle analysis is still inappropriate. Section 1129(b) permits confirmation if the plan does not discriminate unfairly and is fair and equitable to each class that is impaired under the plan and has not accepted the plan. The term "fair and equitable" is defined as to a particular class of creditors. For example, the plan must provide for certain treatment of secured creditors, including, as provided in the Debtor's Plan, deferred payments of the allowed secured claim. See § 1129 (b)(2)(A). As to unsecured creditors, a plan is fair and equitable if the allowed value of the claim is to be paid in full under § 1129(b)(2)(B)(i) or, alternatively, if the holder of a junior claim will not receive or retain under the plan on account of such junior claim or interest any property under § 1129 (b)(2)(B)(ii). As noted by the Supreme Court, this second alternative is what is referred to as the absolute priority rule. See 203 North LaSalle, 119 S.Ct. at 1416.

The 203 North LaSalle case addressed solely the interpretation of the language of § 1129 (b)(2)(B)(ii) and whether the debtor's plan satisfied the absolute priority rule given the fact that old equity retained the exclusive right to contribute new capital and receive ownership interests in the reorganized debtor. 203 North LaSalle, 119 S.Ct. at 1414. The Supreme Court held that the debtor had not satisfied the absolute priority rule in that the opportunity to purchase new equity had not been market tested. The Court did not address the alternative means for satisfying the fair and equitable test, that is, full payment. Nor did the Court abrogate exclusivity. ("Whether a market test would require an opportunity to offer competing plans or would be satisfied

by a right to bid for the same interest sought by old equity, is a question we do not decide here." Id. at 1424). Given the current posture of Debtor's case and its current Plan, it is impossible to reach the 203 North LaSalle analysis.

First, at the present time, it appears Amresco has no standing to raise an objection based on the absolute priority rule since it does not have an unsecured claim. It is questionable whether Lennar will have standing to raise an absolute priority rule objection given its recent "Motion Under Bankruptcy Rule 3013 for Determination for Propriety of Classification," Lennar claims that it is necessary for Debtor to provide for a separate classification for each lien on each hotel claimed as collateral. The reason cited is so that Lennar can determine whether it wishes to make its § 1111 (b) election. If Lennar makes the § 1111(b) election it will no longer be treated as an unsecured creditor for any deficiency and therefore may have no standing as an unsecured creditor.

Second, and more importantly, Debtor's Plan provides for payment in full to all creditors. Under § 1129 (b)(2)(B), paying unsecured creditors in full satisfies the fair and equitable requirement. Perhaps the Debtor's ability to fulfill this promise will be tested ultimately at confirmation, but confirmation is not before the Court now.

In summary, the 203 La Salle decision, while poignant for bankruptcy practitioners simply is not relevant in this case.

A. The Expiration of Exclusivity is Not Before the Court and Does Not Present a Futile Hurdle

Because the Debtor filed a timely Plan and is still within its 180-day exclusivity period, the issue of the expiration of exclusivity and its extension is not yet before the Court. The outcome is not a foregone conclusion as urged by Amresco. As indicated above, termination of exclusivity must be based on a showing of "cause," and not an arbitrary determination that something will or will not occur in the future. Despite the Debtor filing its Plan within three months of its petition, the Disclosure Statement hearing was not set until two and half months later. The Debtor has had no opportunity to solicit acceptances for its Plan and without that opportunity, no party can predict with certainty the result of the balloting process.

Further, there is nothing to prevent the Debtor from requesting an extension of exclusivity and every reason to believe such an extension would be warranted. This case is significant in size with 12 operating hotels in four states. There are over 800 unsecured creditors and about $35,000,000 in total debt. The Debtor

has vigorously pursued its Plan which in filed in three months after filing the case and which provides for payment in full to all creditors. Debtor has reached a beneficial settlement with one of its major creditors and it has operated the hotels in an efficient manner and paid its post-petition expenses as they have become due. These factors have been sufficient "cause" to extend exclusivity. See In re Express One Intern., Inc., 194 B.R. 98, 100 (Bank. E.D. Tex. 1996). (See also In re Gibson & Cushman Dredging Corp., 101 B.R. 405, 410 (E.D.N.Y. 1989), in which the District Court upheld a fourth extension of exclusivity based on the "recalcitrance of the creditors and their intent to liquidate rather than negotiate with the debtor to agree upon an equitable plan of reorganization" and the Debtor's ability to carry on its business during the bankruptcy proceeding which not only preserved the assets but augmented them). If necessary, Debtor will be able to demonstrate that an extension of the 180 days in order to solicit acceptances is warranted.

III. CONCLUSION

Based on the foregoing, Debtor urges the Court to deny the Creditors' request to modify exclusivity.

DATED this 3rd day of January, 2000.

HEBERT, SCHENK & JOHNSEN, P.C.

By /s/ Carolyn J. Johnsen #011894
Carolyn J. Johnsen
1440 East Missouri Avenue
Missouri Commons Suite 125
Phoenix, Arizona 85014-2459
Attorneys for Debtor

COPY of the foregoing mailed or
served via (fax*/ electronic notification**
or hand-delivery if marked ***)
this 3rd day of January, 2000, to:

Office of the U.S. Trustee
P.O. Box 36170
Phoenix, AZ 85067-6170

Thomas J. Salerno (602-253-8129)*
Jordan A. Kroop
Reneè Sandler Shamblin
SQUIRE SANDERS & DEMPSEY, L.L.P.
40 N. Central Ave., Suite 2700
Phoenix, AZ 85004

Laurel M. Isicoff
KOZYAK TROPIN & THROCKMORTON, P.A.
2800 First Union Financial Center
200 S. Biscayne Blvd.
Miami, FL 33131

Randolph J. Haines (602-262-5747)*
LEWIS AND ROCA, LLP
40 North Central
Phoenix, Arizona 85004-4429
Local Counsel for AMRESCO

Daren W. Perkins, Esq.
SNELL & WILMER, L.L.P.
One Arizona Center
Phoenix, Arizona
Local Counsel for GMAC (LaSalle)

David W. Elmquist, Esq.
WINSTEAD SECHREST & MINICK, P.C.
5400 Renaissance Tower
1201 Elm Street
Dallas, Texas 75270-2199
Counsel for GMAC (LaSalle)

Mikel R. Bistrow, Esq.
LUCE, FORWARD, HAMILTON & SCRIPPS, L.L.P
600 West Broadway, Suite 2600
San Diego, California 92101-9886

Douglas G. Zimmerman
Michael G. Helms
JENNINGS, STROUSS & SALMON, P.L.C.
One Renaissance Square
Two North Central Avenue
Phoenix, Arizona 85004-2393
Counsel for Best Western International, Inc.

Tim L. Small, Sr.
Director of Credit
BEN E. KEITH COMPANY
601 E. 7th Street
P.O. Box 2628
Ft. Worth, Texas 76113-2628

Timothy R. Greiner
GREINER Gallagher & Cavanaugh, L.L.C.
2001 Route 46, Suite 202
Parsippany, New Jersey 07054
Counsel for Ramada Franchise Systems, Inc,
Days Inns of America, Inc.

Missouri Department of Revenue
Bankruptcy Unit
ATTN: Gary L. Barnhart
P.O. Box 475
Jefferson City, Missouri 65105-0475

Charles Brackett
Kleberg Law Firm
First City Tower
1001 Fannin, Ste. 1100
Houston, TX 77002-6708
Counsel for Mavco Construction Co.

Steven N. Berger
ENGLEMAN BERGER, P.C.
One Columbus Plaza, Suite 100
3636 North Central Avenue
Phoenix, Arizona 85012-1985
Counsel for Ramada Franchise Systems

James H. Burshtyn
LINEBARGER HEARD GOGGAN BLAIR
GRAHAM PENA & SAMPSON, LLP
1949 South IH 35 (78741)
P.O. Box 17428
Austin, Texas 78760-7777
Counsel for Round Rock ISD

Elizabeth Weller
Monica McCoy-Purdy
Edward Lopez, Jr.
LINEBARGER HEARD GOGGAN BLAIR
GRAHAM PENA & SAMPSON, LLP
2323 Bryan Street, Suite 1720
Dallas, Texas 75201-2691
Counsel for City of Dallas/DISD

Dennis D. Miller, Esq.
EVERS & HENDRICKSON, L.L.P.
155 Montgomery Street, 12th Floor
San Francisco, CA 94104
Counsel for Phoenix Leasing Incorporated

Michael Reed
MCREARY, VESELKA, BRAGG & ALLEN, P.C.
P.O. Box 26990
Austin, Texas 78755-0990
Counsel for County of Williamson
Williamson County RFM
County of Taylor, City of Abilene
Abilene Independent School District

/s/ Jolynn Marquardt

F:\Data\KILBURG.B\9903401\resp-mot-mod-exclsty.wpd